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Ukraine

Dairy and Products Annual

Report

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Report Highlights:
Fluid milk production continued to decline in 2017, following the long-term trend of animal number reduction. This trend will continue into 2018 at a somewhat slower rate. Despite smaller total milk yields, Ukraine significantly increased exports of butter and NFDM at the expense of diverting raw milk supplies to butter and decreased domestic consumption. These exports are not expected to continue in 2018. In 2017, Ukraine is expected to become a net importer of hard cheese for the first time in its history. Overall dairy sector efficiency will likely improve due to increased investments in industrial milk production. Domestic demand has shifted toward cheaper products and remains stable. Exports of almost all processed dairy products to Russia stopped in 2014 and are not expected to recommence.

Data included in this report is not official USDA Data. Official USDA data is available at ***http://www.fas.usda.gov/psd*** **Data for the Autonomous Republic of Crimea is included into the PSD tables wherever possible.**

Executive Summary:

Fluid milk production decreased in 2016 and is expected to remain on a slight downward trend in 2017-18. Ukraine lost a significant cheese export market in Russia in 2014. The domestic market was unable to absorb additional quantities of cheese or alternative dairy products. In 2016-17, Ukrainian consumers were unable to sustain existing dairy product consumption levels due to the on-going economic and political crisis.

The favorable world dairy market prices observed in 2017 partially alleviated the production decline, inspiring some investments into industrial milk production. Households also slowed down their animal number contraction. However, the combined impact of these investments is not sufficient to reverse the overall production decline. Over 65 percent of raw milk is produced in households and this situation is unlikely to change significantly.

Ukrainian milk producers and processors concentrated on the domestic market and actively searched for new foreign markets for their value-added dairy products. The country was able to respond to high world market dairy prices by slightly increased processing activity and re-direction of selected dairy products from the domestic market to foreign markets. The industry was slow to react to price fluctuations due to the significant momentum associated with current animal productivity levels and inability to increase milk production rapidly. However, high world market butter prices inspired exporters which pushed Ukraine into the top 15 butter exporters.

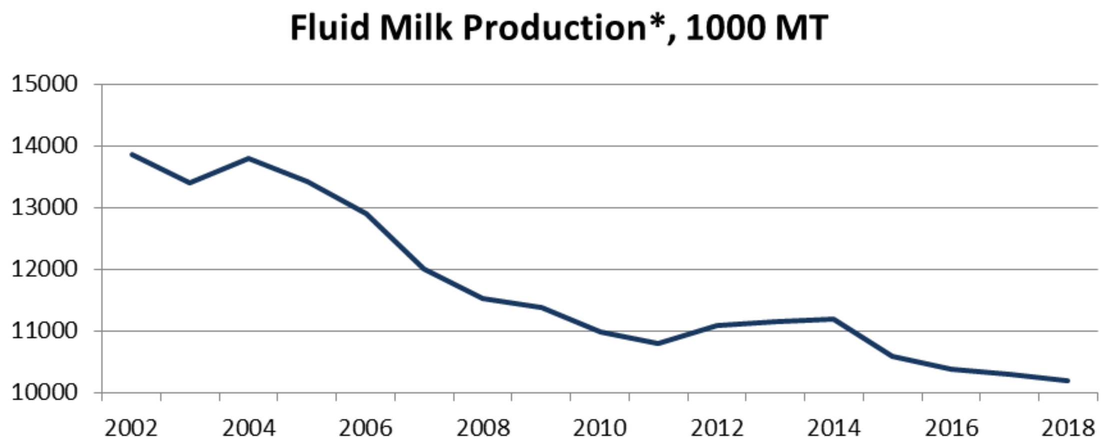
Production:

In 2017, the exchange rate lost its dominating influence on milk and dairy product production and trade. The industry is slowly recovering from the vast currency devaluation of 2014-16. The exchange rate remained stable throughout 2017. Producers benefit from reduced uncertainty over exchange rates, currency regulations, finance availability (including foreign investments), domestic prices, and stable demand, as well as uninterrupted imports of inputs. Simultaneously, Ukrainian producers lost their competitive advantage in the form of shrinking costs that are fixed in local currency.

The World Bank projects modest economic growth at 2 percent in 2017 due to headwinds from the global economic environment and the continued conflict in eastern Ukraine. Domestic demand for dairy products is expected to recover slowly in 2018.

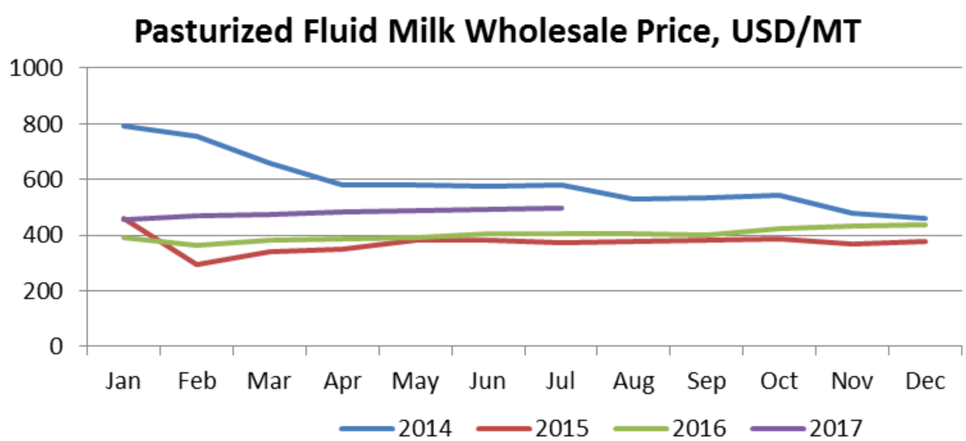
Raw Milk

Milk production in Ukraine is expected to decrease in 2016-17 due to decreased demand from the processors in 2014-16. Milk production responds to market signals with significant lag. Availability of new export markets for Ukrainian butter happened too late in 2016 to positively impact production in 2017. However, export increases will support milk production in 2018.



Source: State Statistics Service of Ukraine; FAS Kyiv calculations;
**Including Crimea*

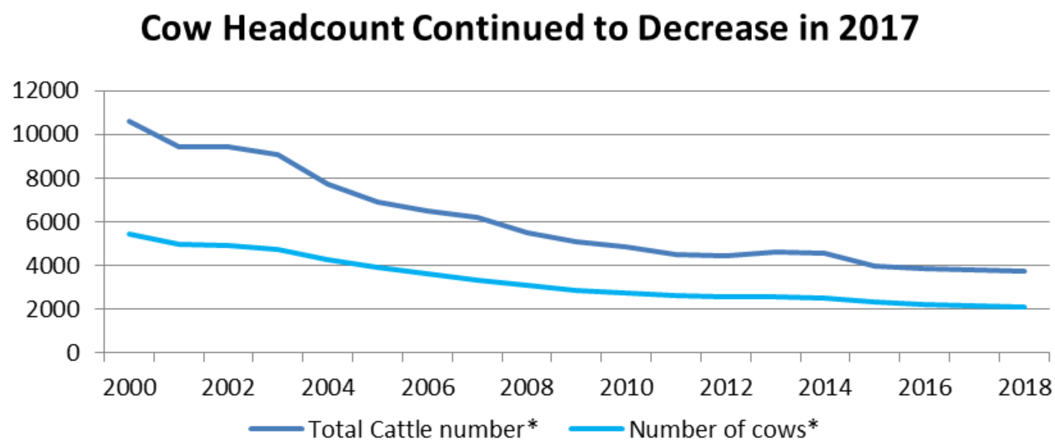
Fluid milk prices started recovery in October-December of 2016 after two years of lows. Nevertheless, current market price remains below the 2014 level, when the Russian market remained partially opened. Increased price is sufficient for profitable large-scale production and has inspired some investments into industrial milk production and processing. The fluid milk price increases slowed the fluid milk production decline that took a deep dive after the Russian market closure in 2014.



Source: Association of Dairy Producers of Ukraine, FAS/Kyiv calculations

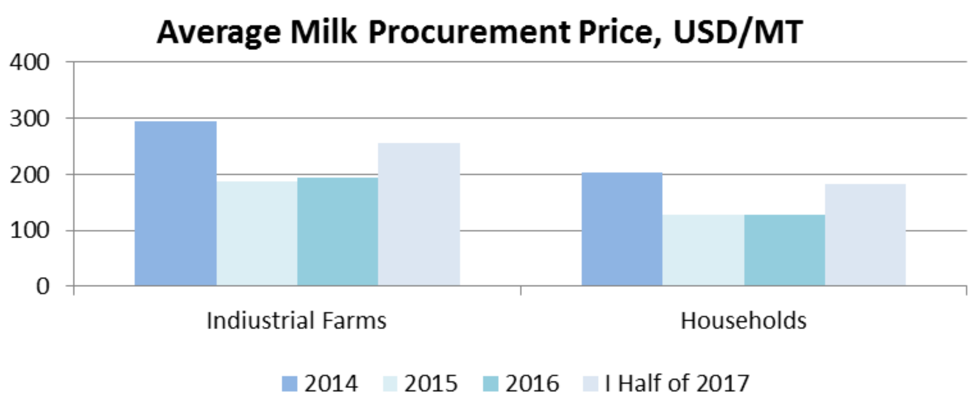
Low milk prices in 2016 facilitated inefficient producers' market exit. Industrial enterprises managed to increase fluid milk production, while reducing animal numbers. Households' raw milk production declined due to decreasing cow numbers. Due to the relatively small share of industrial milk production in Ukraine, total milk production in decreased in the country.

The overall dairy herd size decrease continues a two-decade trend of animal number reduction, accompanied by increased productivity. Being relatively low-efficiency producers, rural households use a low-cost production model with a lot of seasonal grazing and minimum usage of expensive feeds or veterinary medicines.



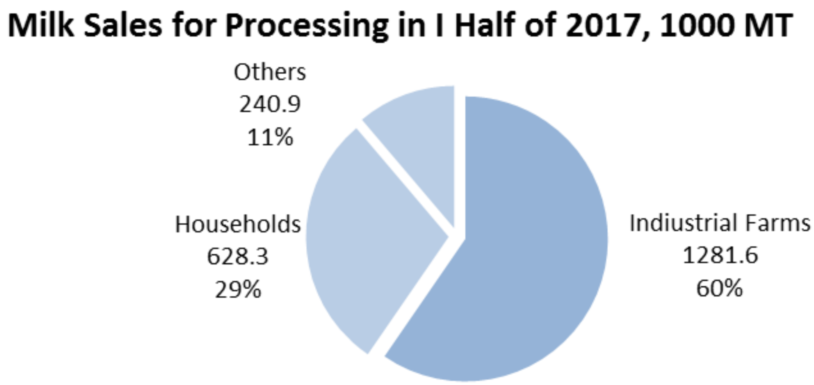
Source: State Statistics Service of Ukraine

Household milk is processed by families into basic, cheap dairy products and sold on open-air markets without any statistical record. There is widespread belief that household milk and dairy products are "organic", "healthier", of "higher quality" and even "safer" than industrially processed products. A significant share of this milk is processed into soft cheese and sour cream. The quality of milk procured from households remains quite low. Bacterial contamination and veterinary problems result in farmgate price discounts. Household producers receive only 60-70 percent of the average price paid for industrially produced milk.



Source: State Statistics Service of Ukraine

Ukrainian dairy processors procure household milk due to insufficient quantity of industrially produced milk. They are trying to improve milk quality through multiple joint processor-rural community programs: sanitary education, milk collection centers with modern chilling equipment, subsidies for veterinary and breeding services, loyalty programs, etc. Simultaneously, Ukrainian processors are increasing the share of industrially processed milk. In 2017, it reached 60 percent of total fluid milk purchases, in comparison to 52 percent in 2014.

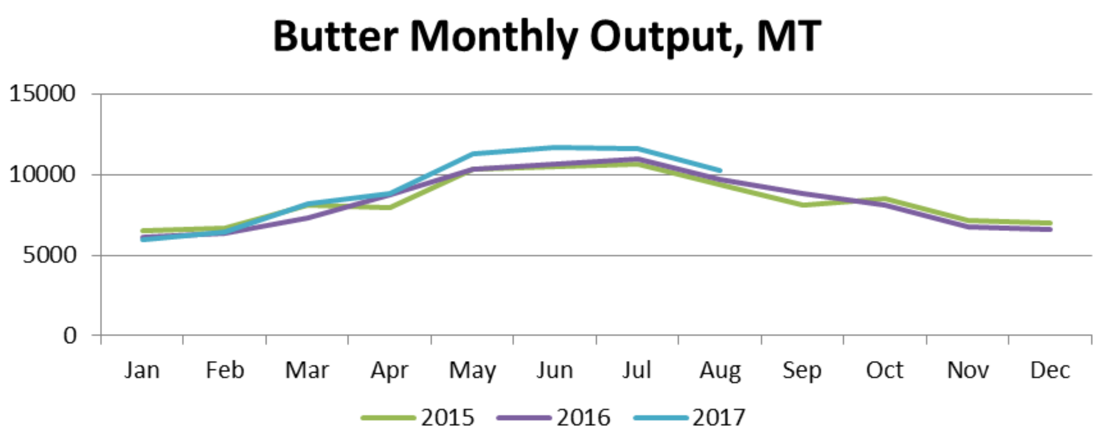


Source: State Statistics Service of Ukraine

Demand for industrially-produced milk increased in 2017 as more export markets for Ukrainian butter were opened. This trend is expected to continue in 2018 despite possible dairy product price decreases.

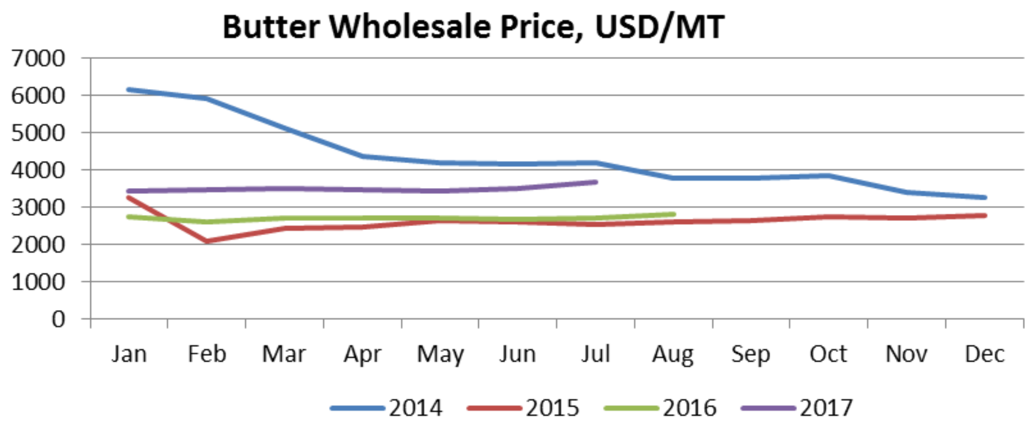
<u>Butter</u>

Butter production in 2017 increased as expected, driven by high domestic prices and export demand. Ukrainian processors were able to utilize excessive milk supplies available after the Russian market closure. Due to the industry's inability to develop export markets for hard cheese, butter and NFDM remained the only major exportable products. Making butter and NFDM is also one of the few ways that lower quality household-produced milk can be used.



Source: State Statistics Service of Ukraine

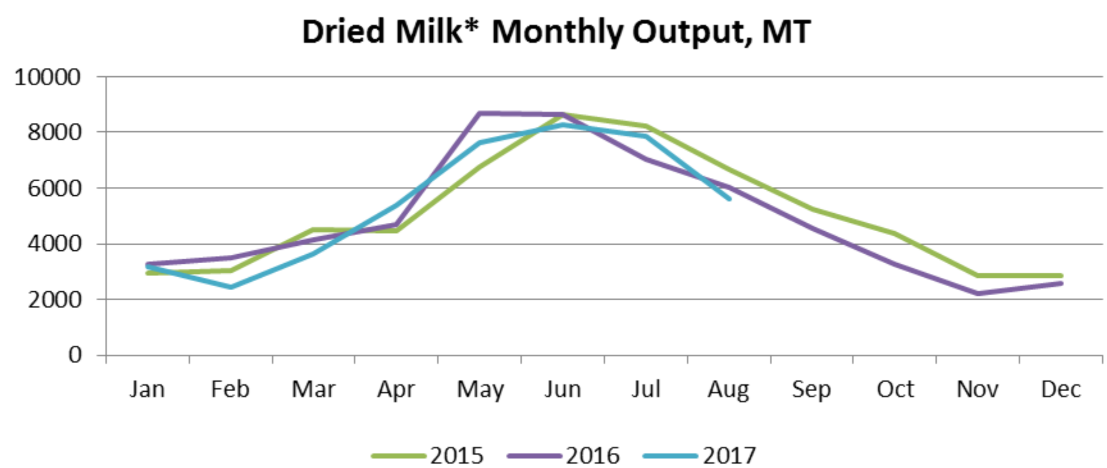
Domestic butter prices increased, following the world market trend. The gap between the world market and Ukrainian domestic prices has widened. Ukrainian consumers, recovering after economic turmoil, were unable to maintain the same consumption levels at higher prices and contracted consumption. Production in the remaining months of 2017 is expected to remain relatively high as long as world market prices remain high and exports are taking place. Further production increase is unlikely due to limited raw milk availability.



Source: State Statistics Service of Ukraine

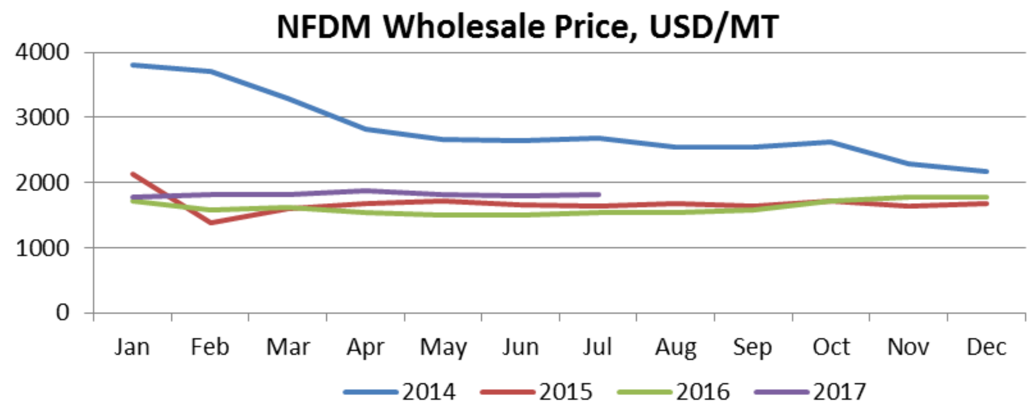
NFDM / WDM

Production of NFDM is closely tied to butter production. Increased demand for butter resulted in a NFDM production increase. NFDM remains to be one of the major exportable commodities with multiple diversified markets in Asia and Africa where Ukrainian NFDM price is the major competitive advantage and maintains production levels. Simultaneously, Ukraine significantly decreased production of WDM which has limited export markets and limited domestic use as a food ingredient.



Source: State Statistics Service of Ukraine
** NFDM and WDM combine*

The NFDM price increased in 2017, but the margin is much smaller compared to that of butter. The domestic market reflected the world market situation where significant NFDM quantities in storage depress prices. Ukrainian processors have little ability to store NFDM and the Ukrainian government does not regulate the dairy market with NFDM procurement programs. All Ukrainian products are likely to be exported or consumed domestically the same year they are produced.



Source: State Statistics Service of Ukraine

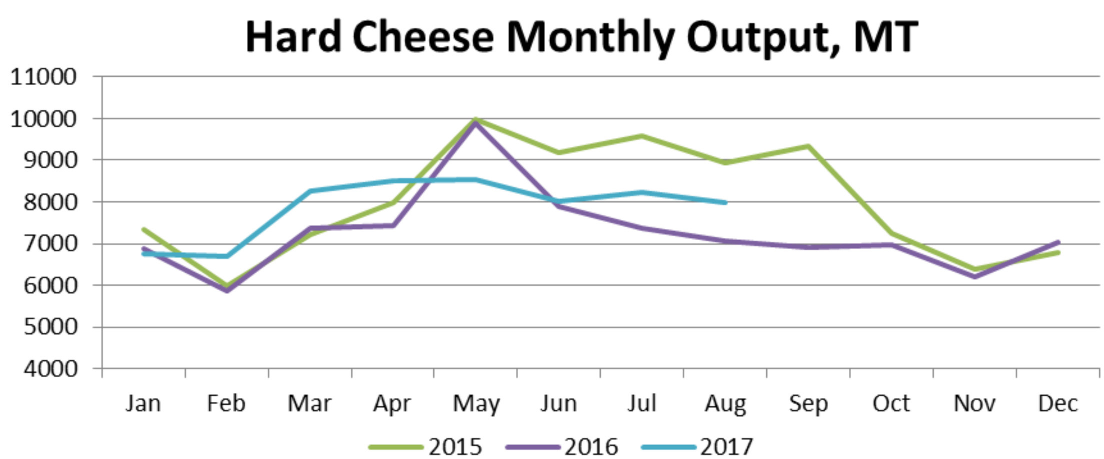
Cheese

Upon closure of the Russian market in 2014, Ukrainian producers were unable to discover new markets for their products. Ukrainian cheese quality often needs improvement, and the type and taste of the product limits its distribution mainly to Former Soviet Union (FSU) countries.

Ukrainian processors diverted excess milk supplies to butter and non-fat dried product to benefit from the high world market price situation.

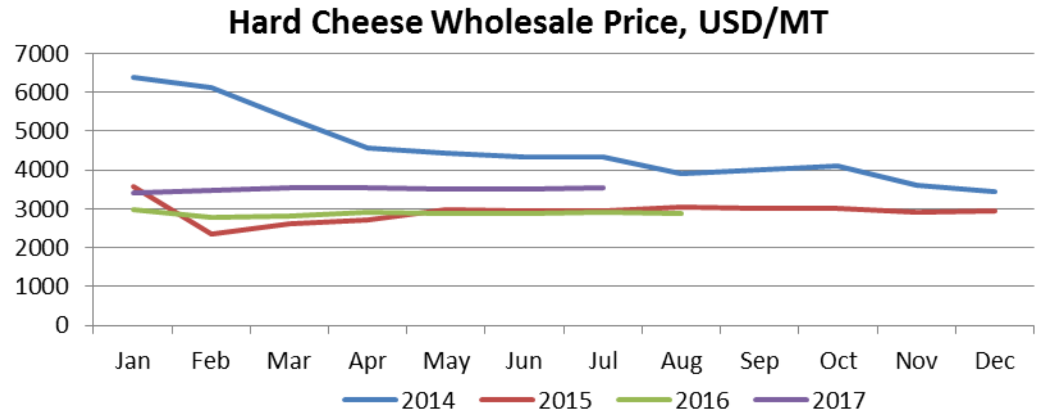
Hard cheese

Facing a shrinking supply of raw fluid milk, Ukrainian processors make their production decisions based on profitability of dairy products. Hard cheese is not a winner in 2017. The Russian market closure limited sales to only domestic consumers. Economic and political crisis pushed demand to the lower market segment with even slimmer margins. Slow economic recovery of 2016-17 did not help cheese producers as many middle class consumers turned toward cheap imported cheese. As a result of the prolonged crisis, production further declined.



Source: State Statistics Service of Ukraine

Despite weak domestic demand, cheese manufacturers had to compete for more expensive raw milk with the rest of the processing industry. The higher prices did not facilitate the sector's much needed domestic consumption increase.



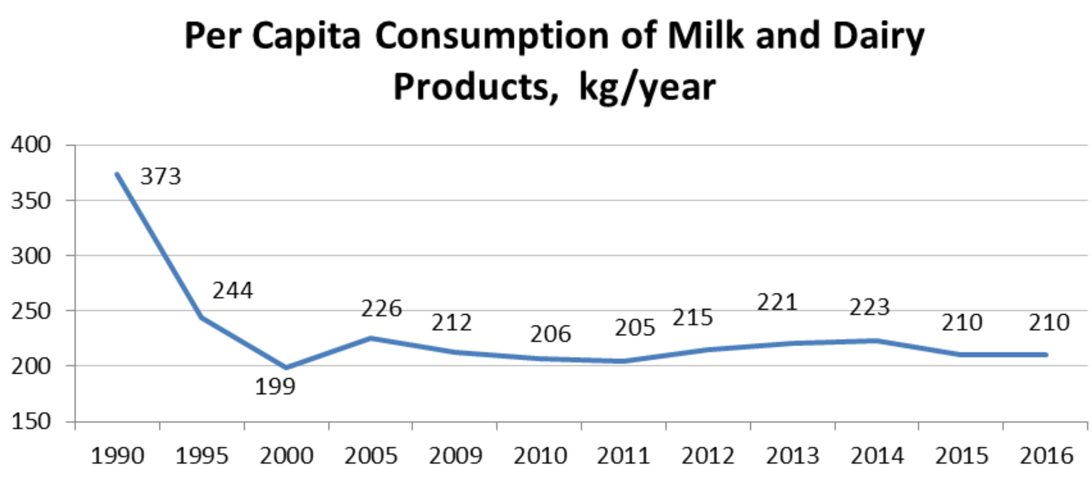
Source: State Statistics Service of Ukraine

Soft and melted cheese

The soft cheese market is dominated by large Ukrainian and multinational processors. A lot of products are based on different variations of the traditional soft cheese products. Producers concentrate on the domestic market with little interests to export due to limited shelf life and consumer preferences on foreign markets.

Consumption:

After major political and economic turmoil of 2013-15, disposable incomes started to recover in 2016-17. Ukrainian official statistics show flat consumption of dairy products in 2015-16, and insignificant growth is expected in 2017.



Source: *State Statistics Service of Ukraine*

Consumption of butter is expected to decline in 2017. Skyrocketing world market prices have attracted a lot of Ukrainian producers to redirect their product abroad. A significant share of low-income consumers was unable to sustain butter consumption levels at the new higher price.

Consumption of margarine and vegetable oils is likely to increase to offset the butter consumption drop.

Consumption of cheese is recovering despite rather high prices. More affluent Ukrainian consumers recognized superior quality of imported cheeses. For the first time in history, in 2017 imports of cheese are expected to be equal to export of cheese (close to 10 TMT for both).

Dairy products remain a staple food in Ukraine and consumption suffers little during economic turmoil. However, it is also slow to grow during economic recovery. A significant share of dairy products is sold at open-air markets. This includes traditional soft cottage cheese, sour cream, some butter, and fluid milk.

Trade:

The Russian cheese market closure in 2014 had significant trade impacts. Ukrainian producers started to decrease animal numbers, but despite the contraction, raw milk excess supplies remained in 2014-17. This additional milk was redirected to whole milk products for domestic consumers as well as to butter and dried milk for export markets. Ukrainian processors intensified their search for new markets demanding higher quality and cheaper milk from domestic producers.

Trade with EU

The EU has partially opened its dairy market for Ukrainian dairy products under the Deep and Comprehensive Free Trade Area (part of the Association Agreement) in late 2015. After multiple facility audits conducted by EU inspectors in recent years, the Commission cleared 19 processing plants (some with approved cold storage facilities) and one dedicated cold storage facility. The list of Ukrainian establishments (published in the most recent European Commission's Third Country Establishments List) includes producers of butter, NFDM, milk, cheese, fluid milk and whole dairy products.

So far, Ukraine has had little success in dairy products exports to the EU. The only significant trade item is non-edible casein. Trade in casein has a long history and was not influenced by the DCFTA. Market developments are likely to take time as Ukrainian traditional products are very different from those demanded by EU consumers. Ukraine also needs to improve product safety and quality using higher quality raw milk.

Trade in dairy Products with EU-28 countries, MT

Commodity	Description	Trade Before DCFTA		Trade After DCFTA			Year To Date		
		2012	2013	2014	2015	2016	07/2016	07/2017	% Change
Dairy Products	Ex 04, 21, 17, 35	6353	3024	5093	5814	7422	3758	6806	81.13
350110	Casein	6216	2999	4850	5595	6149	3711	4179	12.61
040510	Butter	1	1	1	1	741	1	1562	
040210	NFDM	20	0	220	200	443	0	260	
210500	Ice Cream	97	3	6	1	62	30	461	1458.71
040120	Milk/Cream	12	13	11	8	12	7	8	22.98
040690	Cheese, Hard	1	1	2	4	6	4	26	539.64

Source: Global Trade Atlas

Trade with Other Destinations

China approved a number of Ukrainian facilities for import of dairy products in 2015. The list is available under the following link. In recent years the list was expanded to include 27 Ukrainian dairy processing facilities. However, Ukraine exports to China are mostly concentrated and sweetened whey (HS 040410)

Russia introduced additional transit barriers impacting Ukraine's exports to Central Asian countries. After the Russian market loss, Kazakhstan, Turkmenistan, and Uzbekistan remained the major traditional Former Soviet Union (FSU) markets for Ukrainian dairy products. Ukraine's shipments to these countries have to go through Belarus with special seals, permits and tracking devices. Ukraine's efforts to change this situation through the international trade organizations have so far been unsuccessful.

Ukrainian exports now go into two groups of countries: Former Soviet Union countries that import predominately cheese, butter and whole dairy products, and Asian and African importers of Ukrainian dried milk.

Ukraine's Major Export Destinations for Dairy Products (HS 04, 21, 17, 35), Million USD

Partner Country	Calendar Year					Year To Date		
	2012	2013	2014	2015	2016	07/2016	07/2017	% Change
World	550	552	373	214	195	106	172	63
Kazakhstan	47	45	55	26	40	19	25	33
Moldova	26	28	23	19	18	11	14	29
Poland	23	14	18	16	16	9	15	74
Georgia	5	9	13	13	12	7	9	25
Turkmenistan	10	12	13	8	9	6	6	-7
Armenia	5	6	12	8	8	5	7	30
Bangladesh	2	0	11	11	8	3	5	68
Russia	350	376	121	14	4	3	3	-5
Others not Listed	83	61	107	99	80	43	89	n/a

Source: Global Trade Atlas

Ukraine's Major Import Destinations for Dairy Products (HS 04, 21, 17, 35), Million USD

Partner Country	Calendar Year					Year To Date		
	2012	2013	2014	2015	2016	07/2016	07/2017	% Change
World	185	251	153	37	45	24	32	33
Poland	27	36	25	6	11	6	9	51
Germany	11	20	13	8	9	5	7	46
France	20	24	13	5	6	3	3	16
Netherlands	9	10	7	2	4	2	3	46
Belgium	2	6	2	0	3	2	2	16
Italy	7	9	6	2	3	1	2	50
Belarus	27	42	14	1	2	1	1	33
Russia	35	28	18	4	0	0	0	-84
Others not Listed	47	74	56	8	9	5	6	n/a

Source: Global Trade Atlas

Hard cheese

Exports of cheese kept declining 2016 as access to the major markets either disappeared (Russia) or became complicated (Central Asia and other FSU countries). No markets were found to replace Russia as a major buyer of Ukrainian cheese. In 2017, exports recovered insignificantly. Concurrently, imports of hard cheese from Poland for the middle income market segment, and Germany, Netherlands and Italy for upper income consumers, recovered as disposable incomes grew in 2017. For the first time in history, Ukraine bacame a net importer of hard cheese in 2017. The country is likely to be break even for all cheeses (hard and soft) in 2017. Cheese export recovery is not expected in 2018 as no new markets or cheese products are being developed.

Ukraine's Major Export Destinations for Cheese*, MT

Partner Country			Year To Date		
	2015	2016	07/2016	07/2017	%Change
World	9.3	6.1	3.1	3.7	20.2
Kazakhstan	3.4	3.1	1.4	1.6	10.7
Moldova	1.6	1.7	0.9	0.9	-3.2
Egypt	0.1	0.7	0.4	0.6	41.2
Azerbaijan	0.5	0.2	0.1	0.1	-29.1
Russia	2.7	0.0	0.0	0.0	137.9
Others not Listed	0.9	0.4	0.2	0.6	n/a

**Only Hard Cheese (HS 040620, 040630, 040640, 040690)*

Ukraine's Major Import Destinations for Cheese*, MT

Partner Country			Year To Date		
	2015	2016	07/2016	07/2017	%Change
World	4.1	6.0	3.2	4.2	31.6

Poland	1.3	2.6	1.5	1.8	21.3
Germany	1.3	1.4	0.8	0.9	22.7
France	0.5	0.6	0.3	0.4	45.9
Netherlands	0.2	0.5	0.2	0.4	86.2
Italy	0.2	0.2	0.1	0.1	52.0
Russia	0.2	0.0	0.0	0.0	-100.0
Others not Listed	0.5	0.8	0.4	0.6	n/a

**Only Hard Cheese (HS 040620, 040630, 040640, 040690)*

Butter

Butter was one of the most traded products in 2017 due to unusually high export prices. Some processors diverted their raw milk supplies to butter, away from cheese and other products. However, production increase was not significant due to short fluid milk supplies. Increased exports increased the domestic price for butter. Due to high domestic market prices, some Ukrainian consumers were unable to afford butter and switched to margarine and vegetable oils. As such, exports were fueled by both production increase and domestic consumption decrease. New exports put Ukraine in the top 15 world butter exporters; however, the gap between the other top exporters and Ukraine is quite significant.

Ukraine has exhausted its butter export resources and is unlikely to increase production in 2018. The exports are fueled by high world market prices and are expected to drop as soon as prices go down.

Ukraine's Major Export Destinations for Butter, MT

Partner Country			Year To Date		
	2015	2016	07/2016	07/2017	% Change
World	10417	9140	4260	12366	190.32
Georgia	894	1816	955	1176	23.16
Morocco	2309	1323	893	2683	200.39
Egypt	1728	1271	531	691	30.13
Kazakhstan	659	867	69	571	727.64
Netherlands	0	700	0	1118	∞
Armenia	706	614	417	463	11.27
Russia	58	0	0	0	56.36
Others not Listed	4060	2547	1393	5665	n/a

Source: Global Trade Atlas
**HS 040510, 040590*

Skim Milk Powder (Non-Fat Dried Milk)/ Whole Milk power

Unusually significant butter production resulted in increased NFDM production. Ukrainian producers and the government do not have the ability to store NFDM, so it is sold on the world market almost immediately. Officially reported stocks are quite stable and not subject to growth. Ukrainian NFDM export markets are rather diversified with 25-30 destination markets. The low quality of Ukrainian milk pushes it into more price-sensitive markets, mainly in Asia and North Africa. However, industrialized countries such as Denmark and Japan import Ukrainian NFDM for non-food purposes.

Despite increased production, 2018 exports of NFDM are expected to be somewhat lower than 2017 due to increased domestic consumption. Similar to butter, production of NFDN is expected to stabilize in 2018, while export increases as domestic demand for WMP gets satisfied.

Production of WMP decreased significantly while exports grew in 2016-17. Domestic consumption shrank to very low levels. NFDM replaces WMP in the production process in cases when vegetable oils can be used to compensate for butterfat loss. The butterfat gets exported. The situation is expected to change in 2018 when the massive demand for butter wanes.

Ukraine's Major Export Destinations for NFDM*, MT

Partner Country			Year To Date		
	2015	2016	07/2016	07/2017	% Change
World	34.5	34.1	21.9	17.5	-20.1
Kazakhstan	3.7	8.3	6.3	4.9	-22.1
Bangladesh	5.8	5.0	2.2	2.9	29.3
Malaysia	0.0	2.7	2.1	1.0	-51.2
Algeria	1.1	2.1	1.6	1.1	-33.3
Armenia	1.7	1.9	1.5	1.5	2.6
Nigeria	2.7	1.8	0.1	0.3	190.0
Georgia	3.6	1.7	1.1	0.7	-41.0
Moldova	1.5	1.6	1.2	0.7	-44.5
Pakistan	2.1	1.3	1.0	0.4	-65.2
Others not Listed	12.4	7.8	4.8	4.2	n/a

Source: Global Trade Atlas
**HS040210*

Statistical Tables

Fluid Milk PSD Table*

Dairy, Milk, Fluid Ukraine	2016		2017		2018
	Market Year Begin: Jan 2016		Market Year Begin: Jan 2017		
	USDA Official	New Post	USDA Official	New Post	New Post
Cows In Milk	2,226	2,226	2,150	2,172	2,100

Cows Milk Production	10,380	10,375	10,200	10,300	10,250
Other Milk Production	300	250	320	260	270
Total Production	10,680	10,625	10,520	10,560	10,520
Other Imports	0	1	0	1	0
Total Imports		0	0	1	0
Total Supply	10,680	10,626	10,520	10,561	10,520
Other Exports	10	11	11	12	12
Total Exports	10	11	11	12	12
Fluid Use Dom. Consum.	5,190	5,241	5,009	5,199	5,150
Factory Use Consum.	4,380	4,280	4,450	4,300	4,308
Feed Use Dom. Consum.	1,100	1,094	1,050	1,050	1,050
Total Dom. Consumption	10,670	10,615	10,509	10,549	10,458
Total Distribution	10,680	10,626	10,520	10,561	10,470

**These are not official USDA numbers*
Crimea numbers are included

Hard and Soft Cheese PSD Table*

Dairy, Cheese Ukraine	2016		2017		2018
	Market Year Begin: Jan 2016		Market Year Begin: Jan 2017		
	USDA Official	New Post	USDA Official	New Post	New Post
Beginning Stocks	8	8	12	6	6
Production	200	186	206	187	188
Other Imports	7	7	9	10	12
Total Imports	7	7	9	10	12
Total Supply	215	201	227	203	206
Other Exports	8	8	8	10	10
Total Exports	8	8	8	10	10
Human Dom. Consumption	195	187	209	187	190
Other Use, Losses	0	0	0	0	0
Total Dom. Consumption	195	187	209	187	190
Total Use	203	195	217	197	200
Ending Stocks	12	6	10	6	6
Total Distribution	215	201	227	203	206

*These are not official USDA numbers
Crimea numbers are included

Butter PSD Table*

Dairy, Butter Ukraine	2016		2017		2018
	Market Year Begin: Jan 2016		Market Year Begin: Jan 2017		
	USDA Official	New Post	USDA Official	New Post	New Post
Beginning Stocks	5	5	5	7	6
Production	105	103	106	107	104
Other Imports	1	1	1	0	0

Total Imports	1	1	1	0	0
Total Supply	111	109	112	114	110
Other Exports	9	9	12	22	13
Total Exports	9	9	12	22	13
Domestic Consumption	97	93	97	86	91
Total Use	106	105	109	108	104
Ending Stocks	5	7	3	6	6
Total Distribution	111	109	112	114	110

*These are not official USDA numbers
Crimea numbers are included

Nonfat Dry Milk PSD Table*

Dairy, Milk, Nonfat Dry Ukraine	2016		2017		2018
	Market Year Begin: Jan 2016		Market Year Begin: Jan 2017		
	USDA Official	New Post	USDA Official	New Post	New Post
Beginning Stocks	3	3	4	2	2
Production	56	53	58	55	54
Other Imports	0	0	0	0	0
Total Imports	0	0	0	0	0
Total Supply	59	56	62	57	56
Other Exports	34	34	35	32	35
Total Exports	34	34	35	32	35
Human Dom. Consumption	21	20	22	23	19
Other Use, Losses	0	0	0	0	0
Total Dom. Consumption	21	20	22	23	19
Total Use	55	3	57	55	54
Ending Stocks	4	53	5	2	2
Total Distribution	59	0	62	57	56

**These are not official USDA numbers*
Crimea numbers are included

Dry Whole Milk Powder PSD Table*

Dairy, Dry Whole Milk Powder Ukraine	2016		2017		2018
	Market Year Begin: Jan 2016		Market Year Begin: Jan 2017		
	USDA Official	New Post	USDA Official	New Post	New Post
Beginning Stocks	0	0	0	0	0
Production	9	6	9	5	5

Other Imports	0	0	0	0	0
Total Imports	0	0	0	0	0
Total Supply	9	6	9	5	5
Other Exports	2	2	4	4	3
Total Exports	2	2	4	4	3
Human Dom. Consumption	7	4	5	1	2
Other Use, Losses	0	0	0	0	0
Total Dom. Consumption	7	4	5	1	2
Total Use	9	6	9	5	5
Ending Stocks	0	0	0	0	0
Total Distribution	9	6	9	5	5

**These are not official USDA numbers*
Crimea numbers are included